

FAIR POLITICAL PRACTICES COMMISSION
Memorandum

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

From: William J. Lenkeit, Senior Commission Counsel, Legal Division
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Subject: Adoption of Proposed Regulation 18438.5 and Proposed Amendment to Regulation 18438.8

Date: April 25, 2006

I. EXECUTIVE SUMMARY

This project examines issues relating to aggregation of contributions received from individuals or entities with an ownership interest in a party to a proceeding before an agency subject to section 84308 of the Political Reform Act (the “Act”).¹

Pursuant to section 84308, an officer of a public agency is disqualified from participating in decisions affecting a party from whom the official has received campaign contributions of more than \$250 within the 12 months preceding the decision. (Section 84308(c); regulations 18438.1 - 18438.8.) However, other than providing a rule for close corporations, section 84308 does not specify under what circumstances contributions from multiple persons should be aggregated in applying the greater than \$250 threshold.

The proposed regulatory changes addressed herein would enact a conflict-of-interest standard for aggregating contributions made by parents, subsidiaries, and “otherwise related business entities,” as that term is defined in the Act’s conflict-of-interest provisions.

II. BACKGROUND

One of the stated purposes of the Political Reform Act, as set forth in section 81001, subdivision (b), is to assure that “[p]ublic officials, whether elected or appointed, should perform their duties in an impartial manner, free from bias caused by their own financial interests or the financial interests of persons who have supported them.”

¹ The Political Reform Act is contained in sections 81000 through 91014 of the Government Code. All statutory references are to the Government Code unless otherwise indicated. The regulations of the Fair Political Practices Commission, enacted pursuant to the provisions of the Act, are contained in sections 18109, et seq., of title 2 of the California Code of Regulations. All regulatory references are to title 2, division 6 of the California Code of Regulations, unless otherwise indicated.

Although the basic conflict-of-interest rule stated in section 87100 provides that no public official shall make, participate in, or use his official position to influence a governmental decision in which he or she has a financial interest, campaign contributions are not considered economic interests which can result in a conflict of interest under section 87100 of the Act.

Section 84308 was added to the Act by the Legislature in 1982 to make the receipt of campaign contributions, in certain situations, the basis for a public official's disqualification from making a governmental decision. According to staff reports, the statute was enacted in specific response to reports in the *Los Angeles Times* that several California Coastal Commissioners had solicited and received large campaign contributions from persons who had applications pending before them. The purpose of the statute was to assure that appointed members of boards or commissions were not influenced by the receipt of, or the prospect of receiving, campaign contributions from the persons appearing before them, or were able to use their position of authority to unduly influence applicants to make contributions to their campaigns.

Section 84308 applies to all appointed officers of any state agency or local government agency, with the exception of the courts or any agency in the judicial branch of government, the Legislature, the Board of Equalization, constitutional officers, and any local governmental agencies whose members are directly elected by the voters. (Section 84308(a)(3).)

Section 84308 imposes two requirements on officers subject to the section. First, “[n]o officer of an agency shall accept, solicit, or direct a contribution of more than two hundred fifty dollars (\$250) from any party, or his or her agent, or from any participant, or his or her agent, while a proceeding involving a license, permit, or other entitlement for use is pending before the agency and for three months following the date a final decision is rendered in the proceeding....” (Section 84308(b).)

Secondly, if an officer has in fact accepted a contribution of more than \$250 during the last 12 months from a party or participant in a proceeding involving a license, permit, or other entitlement for use pending before an agency, the officer must disclose that fact on the record of the proceeding and must disqualify himself or herself from participating. (Section 84308(c).)

Additionally, section 84308 imposes separate requirements on parties² to a proceeding, stating that any party to a proceeding must disclose on the record of the proceeding any contribution of more than \$250 made within the preceding 12 months by the party or the party's agent to any officer of the agency and prohibits the party, or his or her agent, from making any contribution of more than \$250 to any officer of that agency during the proceeding and for three months following the date a final decision is rendered by the agency in the proceeding. (Section 84308(d).)

² “‘Party’ means any person who files an application for, or is the subject of, a proceeding involving a license, permit, or other entitlement for use.” (Section 84308(a)(1).)

Finally, section 84308 provides that when a closed corporation is a party to, or a participant³ in, a proceeding the majority shareholder is subject to the disclosure and prohibition requirements of the section. This effectively requires that these contributions be considered to have been received from the party. (Section 84308(d).)

III. ISSUE

With the exception of the last provision of the statute, addressing majority shareholders, the statute makes no mention of how contributions are to be treated if received from other entities that have an ownership link or connection with a party to the proceeding. This project proposes regulatory changes that would enact a conflict-of-interest standard in determining what contributions are subject to aggregation under the statute, rather than the “direct and control” standard used for aggregation of campaign contributions in other contexts. The proposed regulatory action would thereby apply the “otherwise related business entity” test used as the standard for conflict-of-interest cases.⁴ This test would require aggregation based on the relationship of the business entities as defined under the Act’s conflict of interest provisions rather a standard based on whether or not the same person(s) direct and control a contribution.

The Enforcement Division proposed this project as a result of continuing problems in the enforcement of section 84308 when contributions are received from a person who is otherwise related to a party in a proceeding, but who does not meet the definition of “party” under the statute. Absent a separate aggregation standard for the purposes of the limits and conflicts-of-interests reporting obligations set forth in section 84308, Commission advice in addressing the issue of aggregation have borrowed from and applied the direction and control standard first enunciated in *Lumsdon and Kahn*. (*Stergakos* Advice Letter, No. I-04-149.) Those rules have not been broad enough to effectively prevent the types of contributions the statute was designed to prevent. For example, recent enforcement cases have found that parent or subsidiary companies have made contributions to officials when one of their related business entities has been a “party” to a proceeding. Under the direction and control standard, these contributions are not aggregated unless they are directed and controlled by the same person or a majority of the same persons.

³ “‘Participant’ means any person who is not a party but who actively supports or opposes a particular decision in a proceeding involving a license, permit, or other entitlement for use and who has a financial interest in the decision, as described in Article 1 (commencing with Section 87100) of Chapter 7. A person actively supports or opposes a particular decision in a proceeding if he or she lobbies in person the officers or employees of the agency, testifies in person before the agency, or otherwise acts to influence officers of the agency.” (Section 84308(a)(2).)

⁴ For a complete discussion of the conflict-of-interest standard versus the “direction and control” standard of aggregation, along with a review of the opinions and Commission advice see the *Prenotice Discussion of Proposed Amendments to Regulation 18438.5*, (“Prenotice Memorandum”) presented at the January 2006 Commission meeting. At the same meeting, the Commission considered codifying the direct and control standard for campaign contributions. The Commission directed staff to bring back the conflict-of-interest standard for aggregation under section 84308 for adoption at the May meeting. Regulation 18215.1 was adopted at the March adoption meeting codifying the direction and control standard for campaign contributions.

IV. DISCUSSION OF AFFECTED REGULATIONS

Regulation 18438.5 At the January Prenotice Commission meeting, staff presented a proposal for adopting new regulation 18438.5 that would have included within the definition of party, any parent or subsidiary of, or otherwise related business entity, (as defined in the Act's conflict-of-interest provisions (regulation 18703.1(d)), to a named applicant or subject of the proceeding. In addition, the regulation proposed using this conflict-of-interest standard for aggregating contributions made by parties and their related business entities as defined.

After receiving public comment, the Commission directed staff to conduct further outreach to determine if there would be any potential problems created for local filing officers relative to the notification provisions created by this new standard, including a determination. Staff was also directed to bring back the project for adoption in May with the proposed conflict-of-interest standard and any additional input received. An interested persons meeting for this purpose was held on March 22, 2006. No comments were received indicating any potential problems.

Enforcement Concerns: Additionally, in the interim since the prenotice meeting, the Enforcement Division has proposed adding amendments to regulation 18438.8 (discussed below) addressing procedures for disclosure of any related entities to the officers regulated under section 84308 who participate in the proceeding.⁵ These amendments were proposed to address Enforcement's concern that without some method of notification provided to the officer, the officer would not have knowledge of the related entity's connection with the party involved in the proceeding.

The proposed language in regulation 18438.5 presented at the January prenotice meeting offered to expand the definition of "party" to include any entities related under the conflict-of-interest standard to the named party or subject of the proceeding, in addition to requiring aggregation of their contributions. In so doing, the related entities would also be parties to the proceeding, and therefore subject to the notification provisions required of all parties by the statute.

The Enforcement Division expressed concern that some of the related entities might not even be aware that they were subject to the requirements in a proceeding in which one of their related entities was involved, and that the officer participating in the proceeding would be even less likely to know of the relationship if one of those related entities made a contribution subject to the requirements of section 84308. Given those concerns, Enforcement believed that the proposed language would be difficult to enforce.

⁵ "Officer" is defined as "any elected or appointed officer of an agency, any alternate to an elected or appointed officer of an agency, and any candidate for elected office in an agency." (Section 84308 (a)(4).) Agency does not include "local governmental agencies whose members are directly elected by the voters, the Legislature, the Board of Equalization, or constitutional officers," but the section does apply to "any person who is a member of an exempted agency but is acting as a voting member of another agency." (Section 84308 (a)(3).)

As a result, proposed amendments to regulation 18438.8 regarding notification procedures reflect the concerns of the Enforcement Division. With the addition of those proposed notification provisions in regulation 18438.8, the language in regulation 18438.5, has been modified to eliminate any definitional changes to the term “party.”

Accordingly, proposed regulation 18438.5 is a simplified version that is limited in its scope to adopting the conflict-of-interest standard for aggregation of contributions between parties and their related entities, rather than the direction and control standard adopted under regulation 18215.1. This standard would apply because, by its terms, regulations 18215.1 states “[f]or purposes of determining when contributions are aggregated under the *provisions of this title*” (emphasis added).⁶

Proposed regulation 18438.5 now reads:

“Notwithstanding the provisions of regulation 18215.1, to determine whether a contribution of more than \$250 has been made by any party to a proceeding, contributions made by a party’s parent, subsidiary, or otherwise related business entity, (as those relationships are defined in title 2 Cal. Code of Regs., section 18703.1(d)) shall be aggregated and treated as if received from the party for purposes of the limitations and disclosure provisions of Government Code section 84308.”

Regulation 18703.1(d) states:

(d) Parent, Subsidiary, Otherwise Related Business Entity, defined.

(1) Parent subsidiary. A parent subsidiary relationship exists when one corporation directly or indirectly owns shares possessing more than 50 percent of the voting power of another corporation.

(2) Otherwise related business entity. Business entities, including corporations, partnerships, joint ventures and any other organizations and enterprises operated for profit, which do not have a parent subsidiary relationship are otherwise related if any one of the following three tests is met:

(A) One business entity has a controlling ownership interest in the other business entity.

(B) There is shared management and control between the entities. In determining whether there is shared management and control, consideration should be given to the following factors:

(i) The same person or substantially the same person owns and manages the two entities;

(ii) There are common or commingled funds or assets;

⁶ Additionally, regulation 18428, adopted by the Commission at the March meeting, and originally included as a companion regulation with this project, requires reporting of aggregated contributions “[w]henver a monetary threshold identified in Chapter 4 and Chapter 5 of the Political Reform Act has been met or exceed.” The monetary thresholds identified regarding contributions under section 84308 are part of chapter 4 of the Act.

(iii) The business entities share the use of the same offices or employees, or otherwise share activities, resources or personnel on a regular basis;

(iv) There is otherwise a regular and close working relationship between the entities; or

(C) A controlling owner (50% or greater interest as a shareholder or as a general partner) in one entity also is a controlling owner in the other entity.

Notification provisions applicable thereto are contained in the proposed amendments to regulation 18438.8.

Proposed Amendments to Regulation 18438.8 As discussed above, Enforcement Division has suggested amendments to regulation 18438.8 requiring disclosure of the names of any entities related to a party in the proceeding. Under proposed new subdivision (b), any party to a proceeding under section 84308 would be required to disclose on the record of the proceeding, the names of any persons whose contributions are required to be aggregated if that person makes a contribution to an officer in the proceeding. For example, if regulation 18438.5 is adopted it would require disclosure of any persons who are a parent, subsidiary, or otherwise related business entity of the party. The disclosure would be required at the time the application was filed or the proceeding commenced, and within 30 days of the date the contribution is made if made at any stage of the proceeding. The requirement would provide some notification on the record, so that an officer would be informed of the identities of any related entities and be on notice of any contributions that may be subject to the provisions of the statute. This provision would place the disclosure burden on the party to the proceeding, as the entity most likely to know both the identities of its related entities and the time at which the party and its related entities would be subject to the provisions of the statute. The regulation would not require the creation of a standard form for this purpose.

The proposed amendments would limit the disclosure of related entities to those that had made contributions to an officer in the proceeding during the 12-month period preceding the filing of the application or the commencement of the proceeding, or at any stage during the preceding.

Under proposed subdivision (b) and the proposed conflict-of-interest standards of regulation 18438.5, if ABC Company is a subsidiary of XYZ Company, and ABC becomes a party to a proceeding, it would be required to disclose, at the time its application was filed or the proceeding is commenced, that XYZ is a related entity only if XYZ has, in fact, made a contribution to an officer involved in the proceeding. Any officer involved in the proceeding would thereby be on notice that any contributions received from XYZ are treated the same as if received from ABC for purposes of the requirements under section 84308. ABC would also be required to disclose any contributions made during the course of the proceeding by XYZ to an officer in the proceeding within 30 days of the date the contribution is made.

Recommendation

Staff recommends that the Commission adopt the proposed language in regulation 18438.5, applying a conflict-of-interest standard in determining aggregation in a proceeding under section 84308. If the Commission rejects this option, the campaign standard of “direction and control” will apply under the provisions of regulation 18215.1, adopted at the March Commission meeting.

Staff further recommends that the disclosure provisions incorporated in the proposed amendments to regulation 18438.8 be adopted so that an officer is provided adequate notice of any related entities that may be subject to aggregation, disclosure, and disqualification under section 84308.

Legal: Section 84308 adoption memo 5-11-06.doc

Attachments

Proposed regulation 18438.5

Proposed amendments to regulation 18438.8